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This 12th Quarterly Report from the Special Inspector General for Iraq Reconstruction (SIGIR) covers the conclusion of a significant phase in the U.S. reconstruction effort in Iraq and the beginning of an important new one. During this quarter, SIGIR progressed on its program to provide aggressive on-the-ground oversight of the Iraq Relief and Reconstruction Fund (IRRF), producing 8 audits and 15 inspections, and pushing forward 78 investigations into fraud, waste, and abuse in Iraq.

The Congress created the IRRF in 2003,¹ funding it with two appropriations amounting to \$21 billion. The IRRF served as the primary financial source for the U.S.-led phase of reconstruction in Iraq. As of the end of 2006, all of the IRRF was contracted, with nearly 80% expended. In 2007, SIGIR will execute detailed reviews of what the American taxpayer received for this investment of U.S. dollars in Iraq's reconstruction.

SIGIR previously observed that continued financial support from the United States and other outside sources will be necessary to support the ongoing recovery of Iraq. This support should aim at strengthening Iraq's capability to provide employment, restore essential services, and build the capacity of the Government of Iraq's (GOI) ministries.

The Congress already has appropriated \$11 billion beyond the IRRF to support relief efforts, primarily for training and equipping Iraq's security forces. Iraq's security forces, however, developed more slowly than

expected, and the security environment has continued to deteriorate. Iraq thus requires a new phase of investment. This phase urgently needs further contributions from international donors through the International Compact for Iraq.

Most important, the GOI must begin to provide significant funding for the relief and reconstruction effort. Ultimately, the sustained recovery of Iraq can be accomplished only by Iraqis.

On January 10, 2007, President Bush presented a new strategic direction for U.S. efforts in Iraq, which includes more U.S. investment in Iraq's economic recovery. This new funding is intended to support the expansion of the Commander's Emergency Response Program (CERP) and the Provincial Reconstruction Teams (PRTs). SIGIR has previously reviewed both programs, finding that CERP achieved success in smaller projects at the local level, and that the PRT program, while facing considerable security constraints, has made progress in its efforts to aid provincial officials in developing their capacity to govern.

In December 2006, Congress passed the Iraq Reconstruction Accountability Act of 2006, extending SIGIR's jurisdiction to include oversight of all FY 2006 funds designated for relief and reconstruction. The effect of this act will ensure that SIGIR will continue its oversight work in Iraq through 2008.

THE YEAR OF TRANSITION IN REVIEW

Early last year, SIGIR identified 2006 as the Year of Transition in Iraq Reconstruction. Throughout 2006, SIGIR tracked progress on a range of issues that challenged the success of the U.S. reconstruction effort in Iraq, including:

- helping the Iraqis fight corruption
- improving security, especially infrastructure security
- building the governance capacities of the Iraqi ministries and provincial governments
- ensuring the sustainability of completed IRRF programs and projects
- increasing the participation of international donors
- strengthening coordination among U.S. reconstruction agencies

SIGIR observed limited progress on each of these issues:

1. **Corruption continues to plague Iraq.** Anticorruption institutions in Iraq are fragmented, and there does not appear to be an internal Iraqi consensus about how these institutions should interact. SIGIR's 2006 audit of U.S. support to anticorruption efforts in Iraq presented a series of recommendations, some of which remain unresolved.
2. **Infrastructure security remains vulnerable.** Electric lines are attacked regularly, and the northern pipelines are

largely inoperable because of interdiction. Iraqi repair crews are frequently unable to work because of repeated attacks. SIGIR's 2006 audit of infrastructure security efforts emphasized the need for greater focus in this area.

3. **The capacity of Iraq's ministries to execute their capital budgets remains weak.** Overcoming this weakness is essential to future progress on reconstruction. A recent SIGIR review of ministry capacity development found that much still needs to be done to improve U.S. support for GOI capacity development.
4. **The sustainability of completed IRRF projects remains a concern.** Although U.S. reconstruction officials have implemented a program to promote project sustainability, a recent SIGIR review indicates weakness in Iraq's management of this program.
5. **Multilateral support for Iraq reconstruction has yet to be realized.** The International Compact for Iraq (the Compact) is expected to advance this essential effort, but it has not yet been officially implemented. For the Compact to succeed, the UN, the World Bank, Iraq's regional neighbors, and the international donor community must engage more aggressively in supporting Iraq's recovery.
6. **Inconsistent coordination among the many U.S. agencies supporting Iraq's reconstruction has hampered the**

effective execution of the U.S. reconstruction program. The newly appointed U.S. coordinator for economic transition may help remediate these problems. SIGIR is conducting reviews of the evolving roles and responsibilities of U.S. agencies as internal reorganizations take place.

As the reconstruction program in Iraq progresses into 2007, the process of transitioning the management of the program to Iraqi control will accelerate. Ensuring the program's successful transition hinges on making effective progress on each of the foregoing issues.

THE END OF THE IRAQ RELIEF AND RECONSTRUCTION FUND

By the end of October 2006, all IRRF funds had been obligated; as of December 31, 2006, approximately 80% had been expended.

Over the course of the U.S.-led reconstruction program, the allocation of IRRF dollars evolved substantially. This evolution was shaped by a series of reprogrammings aimed at ameliorating the increasingly difficult security situation and bolstering programs critical to supporting elections and developing local governance capacity.

These funding adjustments required the transfer of IRRF money from traditional infrastructure projects to security and justice, and democracy projects. Ultimately, IRRF allocations were made to the sectors in these amounts:

- Security and Justice – 34%
- Electricity – 23%
- Water – 12%
- Economic and Societal Development – 12%
- Oil and Gas – 9%

- Transportation and Communications – 4%
- Health Care – 4%²

The Changing Focus of IRRF

These are the highlights of IRRF as it evolved:

April—September 2003, IRRF 1, Relief and Traditional Development: Congress created the IRRF in April 2003 and initially appropriated \$2.475 billion to fund it. The plan to execute IRRF 1 reflected many of the assumptions underlying pre-war planning. The U.S. government anticipated a significant humanitarian crisis and potential oil field fires. Also, the United States expected Iraqi oil revenues to fund major infrastructure reconstruction. Thus, approximately \$1 billion initially was allocated for infrastructure repair. Most IRRF 1 contracts were awarded using competition that was less than full and open.

September 2003—June 2004, Nation-building: The U.S.-led reconstruction program significantly expanded with the advent of the

Coalition Provisional Authority (CPA)—a transitional governing entity established to manage the transfer of democratic sovereignty to a new Iraqi government. The realization that Iraq’s infrastructure was significantly more dilapidated than expected drove CPA to develop a much broader reconstruction plan. In November 2003, Congress responded by appropriating another \$18.4 billion to the IRRF, primarily to fund the CPA’s ambitious plan. IRRF 2 funding was allocated among all the major infrastructure sectors, and major design-build contractors were awarded very large, competitively bid cost-plus contracts. The CPA initially expected to be in place in Iraq for more than two years, but it concluded operations on June 28, 2004, just over a year after its inception.

June 2004—present, A New Approach to Programs and Contracting: During this phase, a significant portion of IRRF 2 funding was shifted from infrastructure to security and democracy. Three significant funding adjustments in late 2004 and early 2005 resulted in the reallocation of more than \$5 billion. The security sector received the largest increase, and the water sector suffered the most significant decrease. U.S. reconstruction leadership also began to move toward the use of direct contracts and away from design-build contracts.

How IRRF Funds Were Spent in Each Sector: A Brief Overview

IRRF funding allocations among the sectors were as follows:

Security and Justice. This sector focused on public-safety requirements (police training and infrastructure), national security (training and equipping the Iraqi Army), and justice (development of the rule of law). Originally, IRRF allocated \$4.56 billion for security and justice projects. The aggravated security situation required the shift of significant funding into this sector, increasing the total amount allocated to nearly \$6.31 billion (an increase of almost 30%).

Electricity. Electricity projects focused on generation, transmission, and distribution networks. Originally, \$5.56 billion was allocated to electricity—the largest initial allocation to any sector—which reflected the CPA’s emphasis on improving Iraq’s capacity to generate power. However, electrical grid output averaged just 4,260 MW this quarter, which is below pre-war levels. The current allocation is nearly \$4.24 billion.

Water. The initial program focused on improving sewerage, access to potable water, and solid-waste management services. Projects included large water-treatment facilities, pumping stations, dams, and rural water supplies. Originally, \$4.33 billion was allocated in this sector; however, the allocation to this sector eventually was cut by nearly 50% (to \$2.13 billion).

Oil and Gas. Oil projects focused on investing in repairing the oil infrastructure and purchasing petroleum products. The IRRF 2 allocation for this sector was originally \$1.89 billion, but this was later reduced by 10% to \$1.72 billion. The Iraqi oil revenues expected

to fund major infrastructure repairs have yet to materialize, partly because attacks on pipelines and poor operations and maintenance of oil facilities have reduced oil exports. Oil production this quarter averaged approximately 2.17 million barrels per day, which is below pre-war levels.

Health Care. The original \$793 million in allocations for this sector included funding for building or refurbishing hospitals and primary healthcare centers (PHCs), repairing and replacing equipment, providing primary health care training, and constructing a pediatric hospital in Basrah. The construction of the PHCs, a major component of this sector, was hampered by poor management by the contractor and weak oversight by the U.S. government in an increasingly insecure environment. The Basrah Children's Hospital fell well behind schedule and greatly exceeded its original budget. The current allocation is approximately \$820 million.

Transportation and Communication. Projects in this sector focused on airports, ports, railroads, roads, and communication

systems and operations. Originally, IRRF allocated \$870 million, and two design-build contractors were hired to complete the work. But GRD-PCO soon realized that Iraqi firms could complete much of the work in the transportation subsector at a lower cost. Transportation became the first subsector to shift from design-build contractors to direct contracting. The current allocation for this sector is approximately \$800 million.

Economic and Societal Development. IRRF initially allocated \$433 million to programs in this sector. After the June 2004 transition to the Iraqi Interim Government and the subsequent program realignments, more money was added to this sector. This reflected the need to support the Iraqi elections process and stimulate employment and economic development. Thus, more than \$1 billion was added to democracy programs, and more than \$660 million was added to private-sector development. The current allocation for this sector is approximately \$2.21 billion.

THE WAY AHEAD

As the U.S. reconstruction effort in Iraq enters its next phase, future economic assistance to Iraq should focus on three areas:

- building the capacity of the GOI to govern on the national and provincial levels, especially in budget execution
- supporting the rule of law by intensifying and expanding programs in the security and justice sector
- stimulating the development of Iraq's private sector

SIGIR observes several areas of significant concern for the next quarter:

Iraqi Budgeting

The GOI continues to struggle to execute its capital budget programs: billions of budgeted GOI dollars remained unspent at the end of 2006. The draft 2007 budget includes a significant portion of those lapsed funds and applies \$10 billion to capital projects. As of this Report, the budget has been submitted to the Council of Representatives for approval.

Expanding Rule of Law and Security Programs

The GOI's most significant challenge continues to be strengthening rule-of-law institutions—the judiciary, prisons, and the police. The United States has spent billions in this area, with limited success to date. SIGIR is conducting a series of reviews of U.S. rule-of-law programs and has completed several reviews of security funding. The security reviews indicate that Iraqi security forces need to develop considerably more logistical and management capacity before they will be able to sustain themselves.

Business Development and Job Creation

Unemployment remains high in Iraq, particularly among young men. Recent U.S.

government efforts to develop programs to stimulate Iraq's economy hold some promise, including the work of the Business Transformation Agency at the Department of Defense (DoD), which seeks to help Iraq restart the state-owned enterprises with the most potential in the short term and also support related private-sector businesses. SIGIR supports continued U.S. efforts to help Iraq stimulate the development of business and industry and thus urges U.S. implementing agencies to develop a coordinated and unified approach to this crucial challenge.

Reconstruction Leadership: The New Economic Transition Coordinator

The recent appointment of a U.S. coordinator for economic transition is a welcome development in the effort to move Iraq's reconstruction management from U.S. to Iraqi control. The coordinator is charged with streamlining cooperation and coordination among U.S. implementing agencies and improving communication between Iraqi officials and U.S. agencies. He will also help to encourage more active participation in Iraq's reconstruction by other donors and international organizations in Iraq.

NOTABLE SIGIR ACTIVITIES THIS QUARTER

To perform its oversight mission this quarter, SIGIR completed 8 audits, which included 20 recommendations, and SIGIR's 15 project assessments presented many construction-related findings. SIGIR investigations continue to pursue allegations of fraud, waste, and abuse in Iraq reconstruction spending.

Audits

During this quarter, SIGIR auditors completed 8 audits. As of January 30, 2007, SIGIR has completed 82 audit products. This quarter, SIGIR also is working on 16 ongoing audits and plans to begin at least 8 more next quarter. This quarter, SIGIR audits addressed a wide range of issues:

- a review of a Department of State (DoS) task order for Iraqi police training, training support, and the construction of several training support camps (\$188.7 million)
- an update on the status of medical equipment purchased to support the delayed PHC project and an assessment of other non-construction contracts supporting the PHC project
- a follow-up on 17 recommendations that SIGIR made in previous audit reports on the control and accountability for contracts, grants, and cash transactions using the Development Fund for Iraq
- a review of government property management controls by the U.S. Agency for

International Development (USAID) and its contractor, Bechtel National, Inc., for contract SPU-C-00-04-00001-00

- a review of improper obligations using IRRF funds, the circumstances related to these obligations, and subsequent actions taken or planned regarding the use of these funds
- a review of internal controls related to disbursements of IRRF apportioned to DoS, DoD, and USAID
- two products on security costs as reported by design-build contractors on IRRF projects
- a review of U.S. government plans and programs for capacity development in Iraqi government ministries

Inspections

SIGIR completed 15 project assessments this quarter, bringing the total number of completed project assessments to 80. Since the beginning of the program, SIGIR has also completed 96 limited on-site inspections and 266 aerial assessments.

Thirteen of the IRRF projects that SIGIR visited this quarter met contractual specifications. Overall, SIGIR reconfirmed the important role of quality control and quality assurance programs in ensuring that contract specifications are met. Contractor and subcontractor performance and weak quality assur-

ance programs were issues at a few project sites that SIGIR visited.

SIGIR found two projects with deficiencies in sustainability, design, and construction. For example, at the *Baghdad Police College*—the subject of a previous quick reaction report—SIGIR confirmed that the contractor had installed inferior wastewater piping and joined it together improperly. Although the contractor had reportedly repaired and replaced the faulty pipe work, SIGIR’s follow-up onsite assessments found continued leakage and other plumbing deficiencies. SIGIR inspectors also found inferior concrete construction in several buildings and faulty electrical wiring, which created potentially hazardous situations.

The Baghdad Police College project had to be descoped because of cost and schedule overruns. The U.S. government managers did not take sufficient steps to ensure project sustainability. As a result of these issues, there has been a delay in turning over the Baghdad Police College to the GOI.

At 13 sites that SIGIR assessed this quarter, the government quality assurance programs effectively monitored the contractor’s construction progress and workmanship.

Investigations

This quarter, SIGIR investigations opened 27 cases and closed 43 preliminary and open cases. Currently, 78 investigations are open, including 23 cases awaiting action under prosecutorial control at the U.S. Department of Justice.

Also this quarter, the International Contract Corruption Task Force identified 36 cases. SIGIR, one of five agencies working jointly on the taskforce, contributed nine cases to this effort.

Since December 2005, SIGIR has worked closely with a range of agencies to suspend and debar contractors for fraud or corrupt practices involving Iraq reconstruction and Army support contracts in Iraq. These cases arise both from criminal indictments filed in federal district courts and allegations of contractor irresponsibility requiring fact-based examination by the Army’s Suspension and Debarment Official.

To date, 14 individuals and companies have been *suspended* based on allegations of fraud and misconduct connected to Iraqi reconstruction and Army support contracts.

As of January 30, 2007, a total of eight have been *debarred*, and four others have been proposed for debarment.

IMPACTS OF SIGIR OPERATIONS

SIGIR oversight continues to produce a wide range of benefits. SIGIR advice and recommendations on policy have promoted economy, efficiency, and effectiveness in the conduct of the U.S. reconstruction program in Iraq and have served as a deterrent to malfeasance. SIGIR's information and analysis has enabled the U.S. government to improve its efforts in Iraq and also to plan more effectively for future efforts.

SIGIR oversight also continues to produce tangible financial benefits. Through December 31, 2006, SIGIR audits have saved or recovered \$50 million and have identified the potential to recover an additional \$106 mil-

lion. SIGIR investigations have recovered or seized \$9.5 million in assets and are working on the recovery of an additional \$15 million. SIGIR inspections have made recommendations to ensure the effective use of an estimated \$39 million in reconstruction projects. SIGIR inspectors also found that engineering improvements to oil pipelines could increase oil exports and potentially increase the volume of Iraqi oil revenues by more than \$1 billion annually if the pipeline can be effectively secured.

For the data supporting these benefits, see Appendix C.

THE HUMAN TOLL

Violence continues to exact a deadly toll on the Iraqi civilians, reconstruction contractors, and journalists in Iraq.

Iraqi civilians continue to be killed, wounded, or displaced from their homes:

- The UN Assistance Mission for Iraq (UNAMI) reported that 6,736 Iraqi civilians were killed this quarter, and at least 6,875 were wounded. In 2006, UNAMI estimates that 34,452 Iraqi civilians were killed, and 36,685 were injured.³
- Violence continues to force Iraqis to leave their homes. The Office of the UN High Commissioner for Refugees estimates that in 2006 alone, 500,000 Iraqis relocated to other areas inside Iraq and that 40,000 to 50,000 continue to flee their homes every month.⁴ In addition, hundreds of thousands have left Iraq for other countries.

U.S. contractors and journalists working in Iraq continue to risk their lives while doing their jobs in Iraq:

- Since Iraq reconstruction began, 768 death claims for civilian contractors working on U.S.-funded projects in Iraq have been filed. In the quarter ending December 31, 2006, the Department of Labor reported 99 new death claims.
- DoS reports that nine U.S. civilians died in Iraq this quarter. Since the beginning of the U.S. reconstruction effort, 205 U.S. civilians have died in Iraq.

In 2006, 32 journalists were killed in Iraq—the highest one-year total ever recorded in a single country, according to the Committee To Protect Journalists.⁵

